

Message Text

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PASS TREASURY AND STR

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E.O. 11652: N/A
TAGS: EFIN, ETRD, LOS, OECD
SUBJECT: JULY 6-7 MEETING OF COMMITTEE ON FISCAL
AFFAIRS (CFA)

REF: A) PARIS 19782 NOTAL, B) PARIS 16847 NOTAL, C)
PARIS 02010, D) CFA/A(77)1

1. BEGIN SUMMARY. IN ADDITION TO APPROVAL OF REPORTS
SUBMITTED BY CFA WORKING PARTIES, CFA HAD SUBSTANTIVE
EXCHANGES ON TAXATION ISSUES IN CONFERENCE ON LAW OF
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THE SEA, ON GATT PANEL REPORTS (DISC ET. AL.) AND ON
ZENITH/US STEEL PETITIONS FOR COUNTERVAILING DUTIES.
US DEL PRESENTED STATEMENT (REF A) OF TREASURY VIEWS
ON LATTER TWO QUESTIONS WHICH POINTED OUT THAT PROSPECTS
FOR EVENTUAL LEGISLATION AMENDING COUNTERVAILING DUTY
STATUTE WOULD BE ENHANCED IF THERE ARE SIGNS OF CONCRETE
PROGRESS TOWARD AGREEMENT ON IMPROVING INTERNATIONAL

RULES ON SUBSIDIES (E.G., ADOPTION IN GATT OF ALL FOUR PANEL REPORTS); NOT UNEXPECTEDLY, IMMEDIATE REACTION OF REPS OF EC, FRANCE, GERMANY AND NETHERLANDS WAS TO REJECT ANY LINKAGE AND TO CALL FOR AMENDMENT OF US LEGISLATION ON COUNTERVAILING DUTIES TO CONFORM WITH ITS "INTERNATIONAL OBLIGATIONS". IN OTHER MATTERS, CFA HEARD WITH INTEREST OUTLINE OF US THINKING ON TAX REFORM PROPOSALS BEING FORMULATED. FRG ATTITUDE TOWARD TREATMENT OF FOREIGN SHAREHOLDERS WAS CLOSELY QUESTIONED IN CONTEXT OF GENERAL EXCHANGE ON MERITS OF IMPUTATION SYSTEM OF CORPORATE TAXATION. END SUMMARY.

2. JULY 6-7 SESSION OF CFA, CHAIRED BY MRS. SMALLWOOD (UK), MOVED QUICKLY THROUGH ITS AGENDA (REF D). ONLY SIGNIFICANT AREA OF CONTROVERSY WAS ON AGENDA ITEM DEALING WITH BORDER TAX ADJUSTMENTS (SEE PARAS 11-13 BELOW).

3. TAX AVOIDANCE AND EVASION:

CHAIRMAN OF WORKING PARTY EIGHT (WESTERBURGEN, NETHERLANDS) REPORTED ON FORMATION OF SMALL WORKING GROUPS ON TAXATION OF: (A) ARTISTES AND ATHLETES (FRENCH RAPPORTEUR); INCOME FROM SHIPPING (US RAPPORTEUR); AND EXCHANGE OF INFORMATION (FRG RAPPORTEUR). LIMITED OFFICIAL USE

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LATTER GROUP, IN CONJUNCTION WITH WP-1'S WORK ON COLLECTION AND INFORMATION, WILL BE AREA OF MAJOR EMPHASIS IN OECD WORK IN COMING YEAR, AND FORTHCOMING MEETING OF TAX INSPECTORS (SEPTEMBER 21-22) BEING PREPARED BY WP-8 IS RELEVANT. CFA APPROVED DRAFT COUNCIL RECOMMENDATION ON TAX AVOIDANCE AND EVASION (CFA(77)6), WHICH IS EXPECTED TO REACH COUNCIL IN SEPTEMBER OR OCTOBER. FRENCH DEL (KERLAN) URGED APPROPRIATE PUBLICITY UPON ADOPTION, AND ALSO SUGGESTED NEED FOR ADDITIONAL SECRETARIAT RESOURCES IN TAXATION DIVISION.

4. DOUBLE TAXATION:

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CHAIRMAN OF WORKING PARTY OH EXE (BUBLOT, BELGIUM)
REPORTED ON WORK BEING DONE FOLLOWING COMPLETION OF
LENGTHY EFFORT TO REVISE THE MODEL CONVENTION FOR
AVOIDANCE OF DOUBLE TAXATION (WHICH WILL BE PUBLISHED
AROUND THE END OF JULY AND APPROPRIATELY PUBLICIZED).
THIS FURTHER WORK CONSISTS OF: (A) POSSIBLE REVISION
OF MODEL CONVENTION ON TAXATION OF ESTATES; (B) INTER-
PRETATION OF CERTAIN ARTICLES OF REVISED MODEL
CONVENTION ON DOUBLE TAXATION; AND (C) TAX ABUSE
(WORKING GROUP HEADED BY US). ON AREA OF TAX ABUSE,
SECRETARIAT WILL SOLICIT WRITTEN SUBMISSIONS BY MEMBER
COUNTRIES ON THEIR EXPERIENCES -- ORAL STATEMENTS WILL
ALSO BE POSSIBLE. FRENCH DEL SAID THAT HE HAD ASKED
UN TO PUT TAX ABUSE QUESTION ON AGENDA OF FORTHCOMING
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MEETING OF ECOSOC GROUP ON TAX TREATIES BETWEEN DEVE-
LOPED AND DEVELOPING COUNTRIES, STARTING OCTOBER 24,
AND SUGGESTED MAKING AVAILABLE TO THAT GROUP THE DRAFT
REPORT BY THIS WP-1 WORKING GROUP. THERE WERE NO OBJEC-
TIONS TO THIS PROCEDURE.

5. SOCIAL AND STATISTICAL ASPECTS OF TAXATION:

CHAIRMAN (CEDERBLAD, SWEDEN) REVIEWED WP-2 WORK PROGRAM. REPORT ON TAXATION OF FINANCIAL ASSETS AND HOME OWNER-SHIP (CFA(77)1) WAS APPROVED -- WITH CAVEAT THAT IT IS SIMPLY A COMPENDIUM OF DIFFERENT APPROACHES UTILIZED -- BUT WILL BE REVISED TO REFLECT LAST MINUTE AMENDMENTS BY SOME COUNTRIES. US DEL (WOODWORTH) SAID THAT SUCH STUDIES ARE USEFUL, AND THAT FURTHER WORK SHOULD BE DONE IN THIS AREA.

6. TAXATION AND MULTINATIONAL ENTERPRISES:

CHAIRMAN OF WORKING PARTY SIX (KERLAN, FRANCE) REPORTED ON STATUS OF THREE PAPERS ON TRANSFER PRICING: (A) REPORT ON TRANSFER OF TECHNOLOGY IS FINISHED, ALTHOUGH IT IS NOT THE LAST WORD; (B) DRAFT OF REPORT ON SERVICES IS TO BE CONSIDERED SOON, WITH US DEL TO PROVIDE A SUPPLEMENT; (C) FIRST DRAFT ON GOODS PAPER IS BEING PREPARED. KERLAN OBSERVED THAT AT SOME POINT SERIES OF NOTES WILL HAVE TO BE CONSIDERED AS AN ENTITY AND THAT MEANWHILE THEY SHOULD REMAIN AS INTERNAL OECD DOCUMENTS, ALTHOUGH THEY COULD BE RELEASED TO OECD CONSULTATIVE GROUPS SUCH AS BIAC AND TUAC. CFA APPROVED THE FINALIZED REPORT ON TRANSFER OF TECHNOLOGY AND AGREED IT COULD ALSO BE PROVIDED, THROUGH THE WP-6 CHAIRMAN, TO ECOSOC TAX GROUP. SECRETARIAT (HACKETT) LIMITED OFFICIAL USE

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REMINDED CFA OF MNE GUIDELINES DEVELOPED BY INVESTMENT COMMITTEE AND NOTED THAT NONE OF CASES CITED BY TUAC (AT CIME JANUARY MEETING) AS VIOLATIONS OF GUIDELINES INVOLVED SECTION COVERING TAXATION. NEVERTHELESS, WHILE SAYING THERE IS NO NEED TO CONSIDER NOW WHETHER REVISIONS TO TAXATION SECTION MIGHT BE MADE, HE SUGGESTED SOME THOUGHT MIGHT BE GIVEN TO THIS QUESTION DURING L978.

7. TAXATION OF ENERGY:

A. CHAIRMAN OF WORKING PARTY SEVEN (MENCK, FRG) REPORTED THAT WP-7 WILL WIND UP ITS WORK BY YEAR END AS PREVIOUS CFA MEETING DECIDED. FACT FINDING REPORT WILL BE PRESENTED AT NEXT CFA MEETING. CFA APPROVED SUMMARY TABLES ON TAX TREATMENT OF ENERGY, DAF/CFA/76.27(LST REV.), AND ALSO REPORT BY BELGIAN DELEGATE (CFA(77)3) ON TAX MEASURES AFFECTING ENERGY DEVELOPMENT AND CONSERVATION. CFA ACCEPTED QUALIFICATION TO REPORT PUT FORTH BY UK DEL - THAT IT SHOULD BE REGARDED AS A USEFUL GUIDE RATHER THAN AS A JUDGMENT ON THE EFFECTIVENESS OF USE OF TAXATION FOR ENERGY POLICY

-- AND AGREED TO TRANSMIT REPORT TO COMMITTEE ON ENERGY
POLICY AND TO IEA WITH THIS CAVEAT. UK DEL SAID HMG
IS NOW PONDERING ROLE OF TAXATION IN ENERGY POLICY AND
WILL

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BE ISSUING "GREEN PAPER" TO STIMULATE DISCUSSION,
PARTICULARLY WITH REGARD TO BALANCE BETWEEN INCENTIVES
TO CONSERVATION AND PRODUCTION.

B. US DEL DESCRIBED TAX PORTION OF ADMINISTRA-
TION'S PROPOSALS FOR A NEW ENERGY POLICY AND SAID WE
ARE PLEASED THAT WAYS AND MEANS COMMITTEE HAS APPROVED
MOST ELEMENTS OF THIS AMBITIOUS PROGRAM. HE EXPRESSED
HOPE THAT BILL COMBINING TAX AND NON-TAX ELEMENTS MIGHT
REACH THE FLOOR OF THE HOUSE BY EARLY AUGUST AND THE
SENATE FINANCE COMMITTEE BEFORE YEAR END. RESPONDING
TO QUESTIONS, WOODWORTH ACKNOWLEDGED THAT ESTIMATED
IMPACT OF PACKAGE ON OIL IMPORTS BY L985 IS BEING
REVISED DOWNWARD FROM 4.5 MBD, PARTLY BECAUSE OF

ERRORS IN ORIGINAL ESTIMATE, BUT NOTED THAT ANALYSIS
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OF IMPACT OF REVISED PACKAGE IS STILL IN PRELIMINARY
STAGE. HE CHARACTERIZED THE TAX RAISING DOMESTIC
PRICE OF OIL TO WORLD LEVEL AS SIMILAR IN EFFECT TO A
WINDFALL PROFITS TAX.

8. TAXATION ASPECTS OF LAW OF THE SEA CONFERENCE:

UK DEL OPPOSED GRANTING ANY SPECIAL TREATMENT TO INTER-
NATIONAL SEABED AUTHORITY - I.E., LEVIES TO INTERNA-
TIONAL BODIES TRADITIONALLY ARE DEDUCTIBLE BUT NOT
CREDITABLE AGAINST DOMESTIC TAXES. US DEL AGREED WITH
THIS GENERAL POSITION BUT POINTED TO SOME COMPLICATED
ISSUES SUCH AS WHETHER TAX BENEFITS GRANTED TO DOMESTIC
OPERATIONS SHOULD BE EXTENDED TO SEABED OPERATIONS.
FRG DEL ADDED THAT TREATMENT SHOULD BE COMPATIBLE WITH
PRINCIPLES OF OECD MODEL CONVENTION ON DOUBLE TAXATION
AND THOSE ESTABLISHED IN ECOSOC TAX GROUP. CANADIAN
DELS EXPRESSED VIEW THAT LEVY BY INTERNATIONAL AUTHORITY,
IF TRULY AN INCOME TAX, MIGHT BE CREDITABLE. THESE
FOUR COUNTRIES AGREED TO SUBMIT NOTES WELL IN ADVANCE
OF NEXT CFA MEETING. QUERIED ON STATUS OF
BILLS BEFORE CONGRESS RELEVANT TO LOS
US DEL NOTED THAT ONLY ONE BILL COVERED TAXATION AND
THAT UNLIKELIHOOD OF RAPID ACTION ON IT PROVIDES
SUFFICIENT TIME TO WORK OUT POLICIES.

9. TAX DEVELOPMENTS:

CFA MERCIFULLY ABSTAINED FROM TOUR D'HORIZON ON DEVE-
LOPMENTS IN MEMBER COUNTRIES IN FAVOR OF EXCHANGES
ON MAIN POINTS RAISE IN PART I OF CFA(77)1:

(A) WORK IN OTHER INTERNATIONAL BODIES ON TAX AVOIDANCE
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AND EVASION. EC REP REPORTED ON STATUS OF WORK IN EC,
AND WESTERBURGEN (NETHERLANDS) GAVE BRIEF SUMMARY OF
REPORT BEING PREPARED BY COUNCIL OF EUROPE. SECRETARIAT
URGED CFA TO ENSURE THAT DELS TO WP-8 COME PREPARED
TO MAKE MEANINGFUL CONTRIBUTIONS ON SCOPE FOR INFORMAL
COOPERATION BETWEEN TAX ADMINISTRATION.

(B) DEVELOPMENTS IN BILATERAL DOUBLE TAXATION TREATIES.

THIS ITEM MAINLY PROVIDED OCCASION FOR EXCHANGES ON
IMPUTATION SYSTEM OF CORPORATE TAXATION AND PROBLEMS
ITS USE RAISES FOR EQUAL TREATMENT OF FOREIGN SHARE-
HOLDERS. FOCUS WAS ON FRG SYSTEM. FRG DEL (MENCK)
TRIED TO DEFLECT PRESSURE WITH PLEA FOR DISCUSSION IN
NARROW GROUP AND BY EMPHASIZING READINESS TO DISCUSS
PROBLEMS. CONCERNING ECONOMIC CONSEQUENCES OF IMPUTA-
TION SYSTEM, FRENCH DEL FELT THAT IT IS DIFFICULT TO
IDENTIFY IMPACT ON FINANCIAL MARKETS AND INVESTMENT,
WHICH IN ANY CASE IS MORE SENSITIVE TO OTHER FACTORS.
UK DEL SAID THERE IS NO QUESTION FOR UK OF SWITCHING
BACK TO CLASSICAL SYSTEM. US DEL BRIEFED CFA ON THE
PROBLEM OF INDIVIDUAL US STATES' TAXATION OF FOREIGN
FIRMS (I.E. CALIFORNIA'S ATTITUDE TOWARD TREASURY'S
AGREEMENT IN PROPOSED BILATERAL TREATY WITH UK TO
ARTICLE LIMITING STATES' SCOPE FOR TAXING INTERNATIONAL
INCOME OF FOREIGN FIRMS).

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TREASURY AND STR

C. US PROPOSALS FOR TAX REFORM. CAUTIONING THAT ADMINISTRATION'S PROPOSALS ARE NOT YET SET, DR. WOODWORTH OUTLINED THREE MAJOR OBJECTIVES:

1) SIMPLIFICATION (E.G., BY CONVERTING PERSONAL EX-EMPTIONS TO CREDITS);

2) MORE EQUITABLE SYSTEM (MAINLY THROUGH METHODS SUCH AS ELIMINATION OR LIMITATION OF CERTAIN DEDUCTIONS, OFFSET BY REDUCTION IN RATES, AND PERHAPS TREATING CAPITAL GAINS AS ORDINARY INCOME; AND

3) PROVIDING INCENTIVES TO ECONOMIC GROWTH (E.G., LIMITED OFFICIAL USE

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FASTER DEPRECIATION, INVESTMENT CREDIT).

AIM IS TO SUBMIT PROPOSALS TO CONGRESS IN SEPTEMBER. WOODWORTH AGREED WITH FRENCH DEL'S OBSERVATION THAT TREATMENT OF CAPITAL GAINS IS HIGHLY POLITICAL SUBJECT BUT POINTED OUT ASPECTS OF US SYSTEM WHICH CAN POTENTIALLY BOOST EFFECTIVE TAXATION ON CAPITAL GAINS ABOVE 35 PERCENT RATE TO ALMOST 50 PERCENT. HE ALSO SAID THAT ADMINISTRATION IS REVIEWING VARIOUS OPTIONS ON POSSIBLE INTEGRATION OF CORPORATE TAX.

10. COLLECTIVE INVESTMENT INSTITUTIONS (CII):

REPORT OF AD HOC GROUP (CFA(77)5) WAS APPROVED, BUT NOTE TO COUNCIL SUBMITTING IT FOR DERESTRICTION WILL MAKE IT CLEAR THAT ITS RECOMMENDED SOLUTION TO PROBLEM OF DOUBLE TAXATION OF CII IS NOT BINDING ON MEMBER GOVERNMENTS AND INDEED WAS NOT AGREED TO BY ALL MEMBERS. AUSTRIA, FRG, UK AND US DELS SPECIFICALLY INDICATED THAT THEY COULD PROBABLY NOT CONFORM THEIR SYSTEMS TO RECOMMENDED METHOD.

11. BORDER TAX ADJUSTMENTS:

US DEL PRESENTED STATEMENT (REF A, BEING REPEATED TO INFO ADDRESSEES). HE ALSO REMINDED OTHER DELS THAT IN DOMESTIC LEGAL TERMS US STATUTE ON COUNTERVAILING DUTIES IS CONTROLLING FACTOR, AS US ADHERENCE TO GATT WAS BY EXECUTIVE AGREEMENT AND HAD NOT BEEN APPROVED BY CONGRESS. FRENCH DEL (KERLAN) REJECTED US ARGUMENT FOR JOINT ADOPTION OF FOUR GATT PANEL REPORTS ON DISC AND COMPARABLE PRACTICES. NETHERLANDS DEL AGREED, ADDING THAT DUTCH HAVE REEXAMINED POSITION BUT CANNOT CHANGE LIMITED OFFICIAL USE

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THEIR VIEW OPPOSING ADOPTION OF PANEL REPORT ON THEIR PRACTICES. BELGIUM REP SAID IN ITS CASE THERE ARE SOME MISUNDERSTANDINGS AS US SUBMISSION INTERPRETING BELGIAN ADMINISTRATIVE PRACTICES IS NO LONGER CORRECT IN SOME AREAS. FRG DEL ARGUED THAT US POSITION INDIRECTLY THREATENED ITS SYSTEM, TOO, AND CLAIMED THAT WHILE DISC, IN DEFERRING CERTAIN DIRECT TAXES, CLEARLY VIOLATES GATT, THE OTHER COUNTRIES' PRACTICES ARE IN LINE WITH ACCEPTED INTERNATIONAL PRACTICES AND, IN PARTICULAR, WITH THE OECD MODEL CONVENTION. MENCK SAID FRG WILL: (A) REGARD TAX EXEMPTION AS NORMAL IF WITHIN TERMS OF OECD CONVENTION; (B) STRICTLY APPLY ARMS-LENGTH PRINCIPLES; AND (C) SEEK SUFFICIENT PROTECTION AGAINST SHIFTING PROFITS TO TAX HAVENS.

12. EC MEMBER COUNTRIES LEFT RESPONSE ON ZENITH/US STEEL PORTION OF WOODWORTH STATEMENT TO EC COMMISSION REPRESENTATIVE WHO EMPHASIZED THAT TVA IS NOT NEGOTIABLE, THAT IN EVENT ADMINISTRATION LOSES COURT CASES EC EXPECTS US TO CHANGE ITS LAWS TO CONFORM WITH ITS INTERNATIONAL OBLIGATIONS, AND THAT NO COMPROMISE IS POSSIBLE. WOODWORTH SAID THAT ADMINISTRATION AGREES WITH MUCH OF EC POSITION AND IS NOT TRYING TO LINK ISSUES BUT, AS A PRACTICAL MATTER, SEES LITTLE PROSPECT

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THAT CONGRESS WOULD REVISE COUNTERVAILING DUTY STATUTES
WITHOUT SOME EVIDENCE OF FLEXIBILITY BY US TRADING
PARTNERS. WE WILL NEED SOME HELP FROM OTHERS, HE SAID,
AND TOO FIRM A POSITION ON BOTH SIDES WOULD BE
UNFORTUNATE.

13. REVISED TABLES ON BORDER TAX ADJUSTMENTS
(DAF/CFA/77.26) WILL BE ISSUED AT END JULY AFTER IN-
CORPORATION OF SUBMISSIONS STILL AWAITED FROM SOME COUN-
TRIES, AND REPORT WILL BE SENT TO TRADE COMMITTEE.

14. OTHER BUSINESS:

FRG DEL EXPRESSED CONCERN AT CERTAIN FEATURES OF L976
INTERNATIONAL BOYCOTT PROVISIONS OF INTERNAL REVENUE
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CODE: (A) INFORMATION APPARENTLY REQUIRED OF FOREIGN
COMPANIES HAVING NO ACTIVITIES IN THE US; AND (B)
EFFECTIVE DENIAL OF TAX CREDITS DUE UNDER BILATERAL
DOUBLE TAXATION TREATY. US DEL RESPONDED THAT
POSSIBILITY OF OBTAINING WAIVERS SHOULD COVER MOST
EXTRATERRITORIAL CASES CITED BY FRG AND THAT US VIEWS
PAYMENT BY FIRM VIOLATING REGULATIONS AS A PENALTY
LEVIED RATHER THAN AS REFUSAL TO GRANT TAX CREDIT.

15. NEXT MEETING OF CFA SCHEDULED FOR JANUARY 18-19.
SALZMAN

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Disposition Comment: 25 YEAR REVIEW
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